

Introduction

The last quarter of the 20th century witnessed a phenomenal rise of the dynamic East Asian economic region comprising China, the four NIEs (newly industrialized economies) of South Korea, Taiwan, Hong Kong and Singapore (dubbed Asia's four "small dragons") and the ASEAN (Association of Southeast Asian Nations) economies of Indonesia, Malaysia, the Philippines and Thailand (dubbed Asia's "tiger economies"). All these economies had sustained strong economic growth at average rates of 6-8% for several decades until 1997 when they were hit, in varying degrees, by the regional financial crisis. The World Bank in one of its well-known development studies referred to the impressive economic success of these economies as the "East Asian Miracle".

Among these high-performance East Asian economies, China stood out with even more impressive economic growth track records. Thanks to its success in market-oriented economic reform, the Chinese economy has chalked up an annual rate of 9.7% real growth during 1979–2000. In absolute terms, China's total GDP sextupled between 1980 and 2000; and its per capita GDP quintupled. By 2000, China's total nominal GNP exceeded US\$1 trillion, making it the world's seventh largest economy. In terms of PPP (purchasing power parity), the Chinese economy is now the world's second largest after the USA — although the PPP measures tend to overstate China's real GNP just as the conventional approach has seriously underestimated it.

On account of its successful open-door policy, China's economy has also achieved greater integration with the global economy. Over the past two decades, China's exports have increased at a hefty annual rate of 17%, from US\$13.7 billion in 1979 to US\$250 billion in 2000. China has now become the world's seventh largest exporting economy. China's

efforts to attract foreign direct investment (FDI) have been even more successful. From 1988 to 2000, actual or utilized FDI in China increased at an annual rate of 23% to reach a cumulative total of US\$339 billion. No other country in the world, besides the United States, receives more FDI. As a result of its success in exports and FDI, China's total foreign exchange reserves in mid-2001 reached US\$180 billion, the second largest in the world next to Japan.

China's economic success is also reflected in several important physical indicators. China not only tops the world in grain production (necessarily so because of its large population) but also in coal, steel and cement. Before Deng Xiaoping introduced economic reform in 1978, home electronics manufacturing was trivial in China. Today, one in four of the world's colour TVs and one in five of the world's fridges are now produced in China. At the start of the economic reform, the whole of China counted only 2 million fixed-line telephone subscribers. By early 2001, China had 160 million fixed-line telephone subscribers, in addition to 111 million mobile phones and 45 million pagers. By the end of 2001, China expects to have 40 million people online as Internet users, just slightly behind Japan. Not just in the "old economy", China is also making rapid progress in "New Economy" areas.

It is not just that the Chinese economy has achieved spectacular growth performance over the past two decades. But it is also sufficiently clear that China's economy is carrying over its high growth momentum into this century, at least for the first two decades. Unlike the other smaller East Asian economies, which can easily exhaust their growth potential, China is a large and diverse continental-sized economy. It has sufficient internal dynamics to sustain growth for a much longer period. This is already evident in 2001 when economic growth in most parts of East Asia has plunged due to the slow-down of the US economy. Only China's economy is still able to keep to its original target of over 7% largely because of its reliance on domestic demand.

However, for China's economy to sustain continuing high growth in the next lap, China will have to come to grips with several structural and institutional constraints, including the unfinished business of economic reform. The two-decade long rapid growth has effectively strengthened China's economic power and raised its people's standard of

living. It has also transformed China from a centrally planned economy to a “socialist market economy”, one that operates increasingly in line with capitalist norms. Many structural problems, however, remain. Weaknesses in the half-reformed fiscal system breeds widespread rent seeking activities at the local levels and cause tensions in state budget. The flawed financial institutions and the biased ownership structure continue to distort resource allocation, leading to huge efficiency losses. Inter-provincial and inter-regional disparity is reaching a level that threatens national unity and social stability. Some of these structural issues will get more acute once China is exposed to greater global competition after its accession to the WTO. What needs to be done in the remaining areas of reform and restructuring will present enormous challenges to the Chinese leadership in the next lap of growth.

This volume is a collection of papers written by researchers and visiting scholars in the East Asian Institute to address the salient problems and issues currently facing the Chinese economy. It consists of five parts and 16 chapters. The first part (three chapters) provides a basis for understanding the long-term structural constraints on China’s economic growth at the turn of the century. The second part (four chapters) discusses fiscal issues, ranging from central-local fiscal relationships and taxation/levy structure to their impact on efficiency of local governance. In a vast economy with 1.2 billion people, these fiscal issues are pivotal in shaping the pattern of development in future. The third part (three chapters) deals with the issue of inter-regional development disparity. This explains why Beijing recently vowed to step up efforts in “Western development” as its new frontiers of economic growth. Infrastructure, in the form of physical and human capital, has been and continues to be a major constraint on the nation’s economic development. Hence the fourth part (four chapters) is devoted to the crucial issue of infrastructure development. As the Chinese economy becomes more integrated into the world economy, the impact of China’s economic growth will be felt beyond its national borders. The volume thus ends with its last part (two chapters) to analyze the regional impact of China’s growth and structural changes.

Many of the papers selected for this volume had been presented at the Institute’s weekly seminars attended actively by academics,

government officials, and business executives and consultants in Singapore and the region. Many chapters contained in this volume should be of topical interest to a wide range of readership.

PART I

Chapter 1, “China’s Economy: Confronting Restructuring and Stability” by WOO Wing Thye, looks into the restructuring imperatives of the Chinese economy. Based on a discussion of the macroeconomic situation by the end of the 1990s, the author questions the rationale of the expansionary fiscal policy adopted by the Chinese government and warns of the long-term negative effects of the fiscal pump-priming measures on financial restructuring. WOO urges China’s policy makers to implement fundamental changes in the capital market by bringing the nation’s financial institutions closer to the operational norms of modern market economies. This, according to the author, will offer China the only chance to achieve sustained growth.

In **Chapter 2**, “The Nature and Sources of Economic Growth in China: Is There TFP Growth”, LIU Zhiqiang reviews the literature on sources of China’s economic growth and emphasizes the importance of productivity growth to the nation’s long-term growth sustainability. The author identifies four contributing factors to productivity growth, namely, the efficiency gains at the micro level, the efficiency improvement in cross-sector resource allocation, the diffusion of technology through foreign direct investment, and the improved infrastructure. Acknowledging the progress of restructuring the state-owned sector restructure and the emergence of the entrepreneurial class, the author expresses optimism towards continuing productivity gains that China’s economy can enjoy in the future.

Chapter 3 by John WONG and REN Caifang deals with a central issue of studying the Chinese economy: “Understanding China’s Statistical System.” Based on their rich experience in this field, the authors provide an objective evaluation of the quality of abundant statistical data published at surprising promptness by the Chinese authorities. This chapter offers a much-needed guideline for avoiding statistical pitfalls in China studies.

In its process of economic restructuring since the early 1990s, China's industrial policy regime has played an active and pivotal role. **Chapter 4**, "China's Industrial Policy and Long-term Structural Planning" by LU Ding describes the regime's features and discusses its impact on the economy's industrial structure and cross-sector resource allocation. The author argues that some strong interventionist features of the regime have to be phased out or modified once China is in the WTO.

PART II

The four chapters in this part investigate fiscal federalism and reforms. An indispensable part of China's two-decade economic reform is a series of fiscal restructuring efforts. From 1978 to 1993, the main thrust of fiscal reform was decentralization and revenue sharing between the central and local governments based on a contractual relationship. Since 1994, a systematic re-centralization of revenues has been phased in through reforms guided by fiscal federalism. These events are reviewed by LIN Shuanglin in **Chapter 5**, "Tax Reforms and Government Revenues in China". LIN notes the decline of government revenue as a proportion of GDP and discusses the factors that contributed to these trends. To tackle the revenue loss, LIN suggests unifying revenue sources, broadening the tax base, equalizing tax burdens, and reinforcing tax laws.

In **Chapter 6**, "Fiscal Decentralization and Economic Growth in China", LIU Zhiqiang and Justin LIN Yifu offer empirical evidence to show that fiscal decentralization from 1970 to 1993 made a positive contribution to the growth process. The duo also finds that, along with the fiscal reform, the rural reform, the non-state sector, and capital accumulation were the key driving forces for growth.

With fiscal decentralization, a notorious problem in China's fiscal system arising, that is, the irregularity of local governments' wanton levies on residents and businesses. In **Chapter 7**, "Too Many Fees and Too Many Charges: China Streamlines Fiscal System", LIN Shuanglin scrutinizes the sources of this problem in the context of "extra-budget" revenue system and the Central Government's "fee reform" since 1999. LIN observes that the "fee reform" is a process of legalization of revenue

collection mechanism and its success therefore hinges on the improvement of the entire legal environment in China.

Changes in the fiscal system inevitably have significant implications for local officials' governing behaviour. CHEN Kang, Arye L. HILLMAN and GU Qingyang discuss impact of fiscal reform on the strategic interaction between the central and local governments in **Chapter 8**, "From the Helping Hand to the Grabbing Hand: Fiscal Federalism and Corruption in China". The trio produces empirical results to argue that the revenue re-centralization process after 1994 had a tendency to change local officials' "helping hand" to "grabbing hand" towards business. This observation offers a novel but controversial interpretation of the deteriorating bureaucratic corruption in China in recent years.

PART III

China's two-decade long economic growth was mainly driven by booms in its coastal (Eastern) region, thanks to the East-West sequencing of opening to external trade and investment. Such sequencing has left behind a legacy of a deteriorated inter-provincial livelihood disparity. This legacy and its relationship with unbalanced inter-region output growth are examined by TIAN Xiaowen and Ron DUNCAN in **Chapter 9**, "China's Inter-Provincial Disparities: 1952–1995". The duo attributes the widening inter-provincial livelihood disparities to the weakened state intervention in inter-region income distribution and the rise of provincial autonomy.

To tackle this problem, the Chinese government announced a shift in its national economic strategy at the dawn of the new century to develop its Western region over next 15 years. The motivation of this policy shift and its impact on the prospects of the Western region development are discussed in detail in **Chapter 10**, "China's Drive to Develop Its Western Region: Rationale and Priorities", by TIAN Xiaowen. The author identifies the government's four priorities in developing the Western region, namely, infrastructure construction, ecological protection, industrial structure adjustment, and the development of science, technology and education. TIAN points out that these priorities,

although in line with the needs of the region, are financially and technically demanding. Their successful implementation hinges on the ability of the central and local governments to mobilize resources in an increasingly market-oriented economy.

As part of the policy shift, Chongqing, a metropolitan area formerly part of Sichuan province, was upgraded into a statutory province by the central government in 1999. In **Chapter 11**, “Economic Openness and Implications for Chongqing’s Development”, John WONG, after showing how physical isolation and “policy isolation” (i.e. lack of economic openness) can hinder economic development, assesses the opportunities for this newly designated province. WONG points out that Chongqing holds great promise for the region’s development in the coming years.

PART IV

Infrastructure development requires private-sector participation as well as government guidance, co-ordination and public investment. The three chapters in this part look at how China is tackling this critical issue.

In **Chapter 12**, “China’s Infrastructure Development”, LIN Shuanglin reviews the physical infrastructure development in the economy over the past twenty years and concludes that infrastructure construction and maintenance have lagged behind the hyper economic growth. LIN recommends several policy adjustments to promote infrastructure financing and construction. According to the author, fiscal decentralization and better law enforcement are pivotal in improving inner city infrastructure and rural infrastructure in the future.

One area where China has successfully overcome its physical infrastructure bottleneck during the last two decades is the development of its telecommunications industry. **Chapter 13**, “Building Up China’s Telecommunications Infrastructure” by LU Ding, delineates state policies that have supported the speedy expansion of the nation’s telecommunication network. The author examines the impact of such success in policy making on the industry’s development and discusses the challenges to the industry in the coming years.

Alongside the development of infrastructure hardware such as roads and ports are the equally crucial “software” components of development such as education, human capital, and legal framework, which are in fact becoming increasingly important for modern economic growth. In **Chapter 14**, “Education and Development: Experiences from East Asia”, John WONG and LIU Zhiqiang evaluate China’s human capital formation in light of the East Asian experience. The duo suggests that, while the government should continue to take the lead in education development, market forces should be allowed to play a bigger role in mobilizing financial and human resources in this sector.

Chapter 15, “China’s Drive to Attract the Return of Its Expatriate Talents” by YU Wing Yin, looks into the measures Beijing has taken recently to facilitate a “reverse brain drain” by attracting overseas Chinese professionals back to China to participate in its economic modernization. The author notes that the policy towards Chinese going overseas to study has become remarkably liberal over the years and the enormous opportunities for entrepreneurship in China has been a magnet to draw back Chinese overseas talents.

PART V

China’s dynamic economic growth has brought about significant geo-economic implications for the region to China’s south. In **Chapter 16** “Implications of China’s Reform and Development on the Asia Pacific,” John WONG assesses the challenges and opportunities brought in by the rise of the Chinese economy to the Asia Pacific economies, in particular, the Southeast Asian economies. **Chapter 17**, “Has the Asian Financial Crisis Eroded China’s Export Competitiveness?” by Friedrich WU, uses a shift-share analysis to show that the competitiveness of China’s manufactured exports has clearly improved vis-à-vis that of the ASEAN-4 (Indonesia, Malaysia, Philippines, and Thailand) since 1994. The author hence dismisses the need for China to use the devaluation of the Chinese *Renminbi* to maintain its export competitiveness during the Asian financial crisis 1997–98.